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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

AETNA LIFE INSURANCE CO.,
Appellant,

v.

MARGARET W. LAVOIE AND ROGER J. LAVOIE, SR.,
Appellees.

On Appeal from the Supreme Court of Alabama

BRIEF AMICI CURIAE FOR AMERICAN COUNCIL OF LIFE INSURANCE AND HEALTH INSURANCE ASSOCIATION OF AMERICA IN SUPPORT OF APPELLANT

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INTERESTS OF THE AMICI [1]

The American Council of Life Insurance ("Council") is the largest life insurance trade association in the United States, representing the interests of 627 member life insurance companies including most of the major life insurers in the country. The Council's members currently hold ninety-five percent of the life insurance in force in legal reserve life insurance companies in the United States. The Health Insurance Association of America ("HIAA") represents the interests of 327 member companies which write over eighty-five percent of the health

[1] Consent from counsel for both parties has been filed with the Clerk of this Court.

insurance written by insurance companies in the United States, and the combined memberships of the HIAA and the Council represent over ninety percent of the health insurance written by insurance companies in the United States.

The opinion of the Supreme Court of Alabama below is important to members of the Council and the HIAA because it enlarges the contract liability of insurers by exposing them to open-ended punitive damages. A new tort cause of action has been grafted onto Alabama insurance contracts which greatly enhances the legal and actuarial liabilities of the members of the Council and the HIAA. As with any form of insurance, a predictable allocation of risks and costs, based upon historical patterns of claim payments, is essential to the financial integrity of a finite fund subject to partial liquidation upon the occurrence of events, such as death or illness. Virtually all insurance companies, including members of the Council and the HIAA, enter into contracts of insurance, establish claim procedures and remedies, calculate premiums and establish reserves in reliance upon these risk allocations. Because the opinion below creates the possibility that contractual remedies may be wholly abrogated by the unpredictable creation of an amorphous new tort cause of action, and that the partial payment or nonpayment of an insurance claim may be accompanied by a substantial, yet unpredictable, punitive award, the stability of the insurance industry in general, and of insurance companies in particular, is seriously threatened. Members of the Council and the HIAA will be forced to incur the increased costs of defending against a proliferation of "bad faith" claims seeking punitive relief, and of making payment of unmeritorious claims to avoid such actions in the future. Faced with large and unpredictable punitive awards—awards not anticipated in the contractual scheme of the insurer-insured relationship—members of the Council and the HIAA may be unable to provide affordable policies of insurance, or, in certain circumstances, to provide such policies at all due to the increased liabilities associated with them. The problems posed by the decision below are serious ones for the companies that sell, and for the people who buy, insurance. The Council and the HIAA thus have a direct and immediate interest in the issues presented in this case.

STATEMENT [2]

Appellees were insured beneficiaries of a group policy of health insurance issued by Aetna Life Insurance Company ("Aetna"), the appellant herein, to the City of Mobile, Alabama. On February 3, 1977, appellee Margaret W. Lavoie was admitted to the Mobile Infirmary Hospital, apparently because of back pains and osteoarthritis. During her twenty-three day stay at the hospital, her doctors conducted extensive diagnostic testing. Her discharge diagnosis was "Osteoarthritis: Mild Psychophysiologic reaction manifested by abdominal pain." Jurisdictional Statement, App. A at 4a.

Appellees filed a claim under the group policy issued by Aetna for an amount totaling $3,028.25. On June 3, 1977, Aetna paid to appellees, the attending physician and the hospital a total of $1,579.74. Pursuant to the terms of the policy of insurance, Aetna declined to pay for various other charges, including some of the diagnostic tests, on the basis that these charges were incurred for care and services not necessary for treatment of the disease involved. The stipulated amount of the charges which Aetna declined to pay is $1,650.22. Aetna again declined to pay the remainder of the claim on November 14, 1977, December 23, 1977 and August 3, 1978.

The Proceedings Below

Appellees filed suit against Aetna alleging, *inter alia*, breach of contract and bad faith failure to pay an insurance claim, and seeking compensatory and punitive damages. Because the State of Alabama did not recognize a cause of action for "bad faith," the action was dismissed. On August 31, 1979, the Supreme Court of Alabama reversed, stating that a cause of action for bad faith failure to pay an insurance claim had been "neither accepted nor rejected" in Alabama. *Lavoie v. Aetna*

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[2] This brief omits references to the reports of the opinions below, a statement of the grounds of jurisdiction, a recitation of constitutional provisions involved, and the questions presented, and adopts the statements in Appellant's brief on these subjects.

Life & Casualty Co., 374 So. 2d 310, 311 (Ala. 1979). Upon remand, the Circuit Court of Mobile County granted Aetna's motion for summary judgment on the "bad faith" claim.

In a trilogy of cases handed down by the Alabama Supreme Court on October 2, 1981, the Court changed the law of Alabama—introducing not only a "bad faith" cause of action,[3] but also the amorphous doctrine of punitive damages in such actions,[4] and set the stage for this appeal. In light of these decisions, the Supreme Court of Alabama reversed the Circuit Court's decision granting summary judgment to Aetna on the "bad faith" claim, and again remanded to the Circuit Court. *Lavoie v. Aetna Life & Casualty Co.*, 405 So. 2d 17, 18 (1981).

On November 4, 1982, a jury returned a verdict against Aetna in favor of appellees, awarding $1,650.22 in compensatory damages and $3.5 million in punitive damages. On December 7, 1984, the Supreme Court of Alabama affirmed the award, departing from its own precedents and again enlarging the new tort. The Court held that a plaintiff need not be entitled to judgment as a matter of law on the contract claim in order for the bad faith action to go to the jury,[5] and that partial payment of a claim would not defeat a bad faith action.[6] This broadening departure from existing precedent was announced in an opinion joined by five justices. Four justices dissented. On December 21, 1984, Aetna filed an Application for Rehearing.

While Aetna's Application for Rehearing was pending, Aetna learned that Justice Embry—the justice who wrote the

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[3] *Chavers v. National Security Fire & Casualty Co.*, 405 So. 2d 1 (Ala. 1981).

[4] *Gulf Atlantic Life Insurance Co. v. Barnes*, 405 So. 2d 916, 925 (Ala. 1981).

[5] In 1982, the Alabama Supreme Court in *National Savings Life Insurance Co. v. Dutton*, 419 So. 2d 1357, 1362 (Ala. 1982), held that, as a general rule, a bad faith claim was not cognizable unless a plaintiff was "entitled to recover on the contract claim as a matter of law."

[6] In *National Security Fire & Casualty Co. v. Bowen*, 417 So. 2d 179, 186 (Ala. 1982), the Alabama Supreme Court had reaffirmed its position that partial payment of a claim would generally defeat the issue of bad faith refusal to pay. *See also Sexton v. Liberty National Life Insurance Co.*, 405 So. 2d 18 (1981).

December 7, 1984 majority decision—had, less than a year before rendering his decision in this case, filed suit against Blue Cross-Blue Shield of Alabama ("Blue Cross"), alleging bad faith failure to pay an insurance claim and seeking punitive damages. On February 21, 1985, Aetna filed motions seeking to disqualify Justice Embry from rendering any decision on Aetna's Application for Rehearing, requesting the other justices to disqualify themselves, and seeking withdrawal of the December 7, 1984 decision. On March 8, 1985, Aetna's disqualification motion was denied with each justice determining individually that he would not recuse himself. Aetna's Application for Rehearing was also overruled. Justice Embry participated in these decisions.

On March 22, 1985, Aetna renewed its challenge to Justice Embry's participation in the decisions below, and moved again for his disqualification. On March 25, 1985, the motion was denied. Justice Embry again participated in the decision.

SUMMARY OF ARGUMENT

I. Judge-made law, like legislation, can unravel a pre-existing contract and frustrate constitutionally protected interests in the protections of that contract. *See Lemon v. Kurtzman,* 411 U.S. 192 (1973); *Chevron Oil Co. v. Huson,* 404 U.S. 97 (1971). As all insurers do, Aetna entered into an insurance contract based upon the liabilities it assumed and the actuarial incidence of those liabilities. Insurance cannot work any other way. The decision below introduces a liability which is not only new, but completely unpredictable and open-ended. By this decision, Alabama denies Aetna "the stability of contractual obligations" which the Contract Clause guarantees. *United States Trust Co. of New York v. New Jersey,* 431 U.S. 1, 15 (1977). The essential stability is no less undermined by nine officials in court than by a legislature in session. This Court should not apply *Tidal Oil Company v. Flanagan,* 263 U.S. 444 (1924), a case whose jurisprudential basis is now recognized to be unrealistic and outmoded, to deny the necessary relief.

II. The award of punitive damages below—more than 2,100 times the actual damages in a case which did not involve

invasion of any basic right or imposition of any severe or continuing injury—was imposed without any coherent substantive standards and without any particular procedural safeguards to ensure that the award was rational, fair, or based upon intelligible standards. This offends both due process and the Eighth Amendment prohibition against excessive fines. It is clear that the award was punishment—and very serious punishment indeed. It is also clear that any criminal defendant faced with a $100 misdemeanor, and any jury charged with imposing it, would have been provided clearer standards and more exacting guidance than that provided to Aetna and the jury below. "Bad faith" and the distinctions between negligence and malice are concepts too blurry to support the huge and unpredictable range of results available to juries. The result reflected in the verdict below demonstrates all too clearly the imprecision in asking juries to draw such distinctions. A higher standard of proof, and a clearer definition of the predicate conduct, are required, at the very least, to restore a semblance of due process.

The award of $3.5 million itself violates the Eighth Amendment as well because it is grossly disproportionate to the offense charged. Punitive damages are civil fines with penal purposes, and, as punishment, the basic Eighth Amendment principle of proportionality should apply to them. This principle, which has been applied since the Magna Carta, is, like other legal principles here, a bulwark against arbitrariness and jury passion. The " 'parallel limitations' on bail, fines, and other punishments", *Solem v. Helm*, 463 U.S. 277, 289 (1983), embodied in the Eighth Amendment should apply to an exaction that operates as a fine. That the jury exacted a fine without the support of either a criminal finding or the limits of a criminal statute should argue for, rather than against, relief.

Although the Eighth Amendment has yet to be applied in a punitive damages case, the time is now ripe. The proliferation of punitive awards, the meaningless standards, the profligacy of the amounts assessed all demonstrate that there is no rational or reliable jurisprudence to be applied here if the Due Process Clause and the Eighth Amendment are not. Punitive damages become a windfall for the plaintiff, and a spring-gun in the

woods—a random, cruel surprise—for defendants. Punitive damages should not continue to enjoy an immunity from constitutional scrutiny.

ARGUMENT

I. THE CREATION OF A NEW TORT CAUSE OF ACTION RETROACTIVELY APPLICABLE TO EXISTING CONTRACTS CONSTITUTES AN IMPAIRMENT OF CONTRACTUAL OBLIGATIONS IN CONTRAVENTION OF THE CONTRACT CLAUSE

If the Alabama legislature had passed a statute altering the remedial scheme embodied in contracts of insurance in Alabama by creating a new tort cause of action which was retroactively applicable to those existing contracts, there would be no doubt that the state had violated the Contract Clause of the United States Constitution. *See Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234, *reh'g denied,* 439 U.S. 886 (1978); *United States Trust Co. of New York v. New Jersey,* 431 U.S. 1 (1977). The mere fact that the unanticipated creation of new contractual liabilities, under the guise of the tort of bad faith, was the product of judicial legislation, as opposed to statutory enactment, should not shield this action from constitutional scrutiny.

Judges as well as legislators make law, and judge-made laws, like statutes, engender constitutionally protected reliance interests. That judges *make* law has been expressly acknowledged by this Court in a series of recent decisions which recognize a doctrine of nonretroactivity in cases where unanticipated federal judicial rulings would upset well-founded reliance interests. *See, e.g., Arizona Governing Committee v. Norris,* 463 U.S. 1073 (1983); *Hill v. Stone,* 421 U.S. 289, *reh'g denied,* 422 U.S. 1029 (1975); *Lemon v. Kurtzman,* 411 U.S. 192 (1973); *Chevron Oil Co v. Huson,* 404 U.S. 97 (1971); *City of Phoenix v. Kolodziejski,* 399 U.S. 204 (1970); *Cipriano v. City of Houma,* 395 U.S. 701 (1969). In these cases, the Court recognized the "fact of legal life" that judges, as well as state legislators, make law and that "even judge-made rules of law

are hard facts on which people must rely in making decisions and in shaping their conduct." *Lemon v. Kurtzman,* 411 U.S. at 199 (1973).[7] Thus, when this Court determines whether to apply a constitutional decision retroactively, it now engages in a "process of reconciling the constitutional interests reflected in a new rule of law with reliance interests founded upon the old." *Lemon,* 411 U.S. at 198.[8] Implicit in this process is a recognition by this Court that these reliance interests can themselves reach constitutional proportions, and cannot be swept away with the old rule of law.

The reliance interests of Aetna in particular and of insurers in general who contract to provide insurance in Alabama are significant. As this Court recognized in *Allied Structural Steel Co. v. Spannaus,* 438 U.S. at 246-47, reliance interests are particularly strong in the business of insurance. Insurance is essentially a system of private ordering—the consensual establishment of legal rights and obligations between parties. As with any contract, insurance contracts cannot be repugnant to law, and the system of law existing at the time of the contract supplements, without impairing, this consensual relationship.

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[7] The need for judicial accountability to constitutional standards when judges are making law—particularly laws which have broad impact through retroactive as well as prospective application—is dramatically illustrated by this case. The substance of the rule applied will virtually always be easier to assess than the interest of the tribunal. A reviewing court can focus upon substantive and meaningful standards in making law to ensure that constitutional interests are protected, and absolve itself generally of review of the judicial processes of state tribunals. This approach allows this Court to face substantial constitutional issues, to decide cases with resort to traditional substantive principles, and to avoid making *ad hoc,* and sometimes difficult, decisions of judicial ethics. For insurers, like Aetna, who do business in Alabama, reliable protection against encroachment upon constitutional rights must come from adherence to general constitutional standards, and not from after-the-fact scrutiny of the bias and interests of a particular tribunal.

[8] *See also Chevron Oil Co. v. Huson,* 404 U.S. 97 (1971). In *Chevron,* this Court articulated a three-part test, which has been followed in subsequent cases, to determine when the doctrine of nonretroactivity will apply: (1) whether the new decision is a clear break from prior law which was not foreshadowed; (2) whether retroactive effect is necessary for the operation of the new principles announced; and (3) whether substantial inequity would result from a retroactive application. *Id.* at 106-108.

Thus, cognizant of the laws of the states in which they contract to provide insurance, insurers like Aetna assess their potential liabilities, calculate premiums, allocate reserves, and enter into contracts of insurance.

In this case, Aetna, an out-of-state insurer, entered into a contract of insurance with the City of Mobile in 1967. That contract was made by Aetna with knowledge of its obligations under Alabama's pervasive insurance laws,[9] and with awareness of the decisions of the Alabama courts interpreting those laws. This contract, like any other contract in Alabama, was subject to the general rule that no punitive damages may be awarded in contract actions.[10]

In a series of decisions in 1981—fourteen years after Aetna had contracted to provide insurance to the City of Mobile—the Supreme Court of Alabama drastically upset the reliance interests of Aetna by legislating an entirely new tort cause of action which it retroactively applied in 1984 to Aetna's 1967 contract of insurance. Significantly, the Alabama Supreme Court was not reinterpreting existing laws or decisions when it ruled that a cause of action for bad faith failure to pay an insurance claim existed in Alabama. Instead, it created an entirely new remedy enormously increasing the potential liability for breach of contract—a remedy which had not previously existed in Alabama—and labeled it as the tort of "bad faith." By so doing, the Alabama Supreme Court abrogated the consensual arrangement between Aetna and the City of Mobile, and imposed upon Aetna a $3.5 million liability which could not have been anticipated at the time of contracting.

The impact of abrogating these reliance interests is severe, and completely at odds with the central concern of the Contract

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[9] Insurance companies, and contracts of insurance, are subject to comprehensive regulation in Alabama. Indeed, the Alabama Insurance Code occupies nearly an entire volume of the Code of Alabama, and consists of 40 chapters regulating insurance in general as well as specific types of insurance. *See* Ala. Code §§ 27-1 through 27-40 (1975).

[10] *See, e.g., Wood v. Citronelle-Mobile Gathering System Company*, 409 F.2d 367 (5th Cir. 1968) (applying Alabama law); *Geohagan v. General Motors Corp.*, 291 Ala. 167, 279 So.2d 436 (1973).

Clause: "to encourage trade and credit by promoting confidence in the stability of contractual obligations." *United States Trust Co. of New York v. New Jersey,* 431 U.S. at 15. The decision below undercuts any expectation of stability in the insurance industry in Alabama.[11] It eliminates from the insurer's considerations the existing law of the state in which it contracts, and exposes the insurer to unforeseen and unpredictable creations of new obligations by state courts—not in small matters of detail, but, in this case, increasing liability more than 2,100 times.[12]

This Court's decision in *Tidal Oil Company v. Flanagan,* 263 U.S. 444 (1924), that the Contract Clause was directed only to impairments of contracts by legislation, and not by judgments of state courts, poses the only possible bar to concluding that the decision below violates the Contract Clause. *Tidal Oil,* however, runs counter to the central concern of the Contract Clause, and rests upon a formalistic and outmoded view of the law which holds that judges do not make new law, but simply declare what the law has always been.[13] Because this view is inconsistent with the Court's retroactivity decisions,

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[11] Moreover, the imposition of unpredictable and substantial punitive damages upon insurance companies hampers compliance with and enforcement of state insurance laws and regulations, particularly those requirements relating to the maintenance of adequate reserves and requirements designed to ensure the solvency of insurance companies.

[12] This Court recently recognized the unfairness of applying laws which were not within the parties' expectations at the time of contracting. In *Phillips Petroleum Co. v. Shutts,* No. 84-233 (June 26, 1985), the Court concluded that Kansas contract and equity law could not be applied to transactions of the parties in a manner consistent with due process, stating (at 25) (citations omitted):

> When considering fairness in this context, an important element is the expectation of the parties .... There is no indication that when the leases involving land and royalty owners outside of Kansas were executed, the parties had any idea that Kansas law would control.

[13] Moreover, the historical basis of *Tidal Oil* is suspect. As early as 1863, this Court in *Gelpcke v. City of Dubuque,* 1 Wall. 175, expressed an interpretation of the Clause which is more consonant with its purpose—namely, that if a contract, when made, is valid, it cannot be impaired by subsequent legislation or by judical decision altering the construction of the law.

this Court must reconcile *Tidal Oil* with the realities of modern-day jurisprudence.[14]

Only by protecting Aetna's valid contractual expectations from unpredictable legislation by the judiciary can this Court preserve the values embodied in the Contract Clause. To hold this Clause inapplicable in this case would be to permit Alabama to accomplish through its judiciary what it could not constitutionally do through its legislature.

II. THE DECISION OF THE SUPREME COURT OF ALABAMA UNPHOLDING MASSIVE PUNITIVE DAMAGES SHOULD NOT STAND UNDER DUE PROCESS OR THE EIGHTH AMENDMENT

A. The Assessment of Punitive Damages Against Appellant is Violative of Due Process

Punitive damages are not "a favorite of the law." *See Smith v. Wade,* 461 U.S. 30, 58 (1983) (Rehnquist, J., dissenting). They are an historical anomaly, transplanted in neo-natal form to American soil from eighteenth century England and nurtured by early American courts which employed punitive damages to compensate victims in small amounts for intangible injuries which the law otherwise did not recognize.[15] Punitive damages were thus awarded in small sums to victims

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[14] *Tidal Oil* is also inconsistent with other decisions of this Court. This Court *has* interpreted "law" to mean common law in the context of the First Amendment, which provides that "Congress shall make no law . . . abridging the freedom of speech." Even though the First Amendment refers specifically to law made by Congress, this Court has given the Amendment a broader interpretation. *See, e.g., Bridges v. California,* 314 U.S. 252 (1941) (applied to judicial contempt citations); *New York Times Co. v. Sullivan,* 376 U.S. 254 (1964) (applied to common law actions of libel against public officials). *Cf. The Sunday Times v. United Kingdom,* 2 E. H. R. R. 245, 270 (European Court of Human Rights 1979) (" 'law' . . . covers not only statute but also unwritten law").

[15] The doctrine of punitive damages was recognized in 1851 by this Court in a modest way in *Day v. Woodworth,* 13 Howard 363 (1851). In a passage considered to be the foundation of punitive damages in American law, Justice Grier, writing for the Court, stated (13 Howard at 371):

> It is a well-established principle of the common law, that in actions of trespass and all actions on the case for torts, a jury may

(footnote continues)

of tortious conduct, such as libel or slander, where actual damages for humiliation or affronts to dignity were largely unascertainable. *See* Nelson, *Punishment for Profit: An Examination of the Punitive Damage Award in Strict Liability,* 18 Forum 377, 380-81 (1983).

From this small beginning, punitive damages have recently branched far beyond their origins in insult torts and have been stretched beyond the limits of their validity.[16] The expansion of this doctrine beyond the traditional tort areas, without historical justification, has brought an explosive increase in the size and frequency of punitive damages awards[17]—a phenomenon strikingly evident in this case, where a $3.5 million punitive damages award was upheld against Aetna for failure to pay a portion of a $3,000 insurance claim. Moreover, staggering

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> inflict what are called exemplary, punitive or vindictive damages upon a defendant, having in view the enormity of his offence rather than the measure of compensation to the plaintiff. . . . In many civil actions, such as libel, slander, seduction, &c., the wrong done to the plaintiff is incapable of being measured by a money standard; and the damages assessed depend on the circumstances, showing the degree of moral turpitude or atrocity of the defendant's conduct, and may properly be termed exemplary or vindictive rather than compensatory.

[16] As has been well said in another context, "these laws are being extrapolated to places where they no longer apply." Bernstein, "Dread Singularities" (Book Review), New York Times Book Review, April 25, 1982, p. 10.

[17] The seemingly uncontrolled growth in both the size and frequency of punitive damages awards is evident in product liability and mass tort cases. *See, e.g., O'Gilvie v. International Platex,* No. 83-1846-K (D. Kan. May 24, 1985) ($10 million jury award of punitive damages reduced to $1.35 million after defendant implemented remedial measures); *Grimshaw v. Ford Motor Co.,* 119 Cal. App. 3d 757, 174 Cal. Rptr. 348 (1981) ($125 million punitive award remitted to $3.5 million); *Ford Motor Company v. Stubblefield,* 319 S.E.2d 460 (Ga. App. 1984) ($8 million); *Palmer v. A.H. Robins Co.,* 684 P.2d 187 (Colo. 1984) ($6.2 million); *Dorsey v. Honda Motor Co.,* 655 F.2d 650 (5th Cir. 1981) ($5 million), *modified on other grounds,* 670 F.2d 21 (5th Cir.), *cert. denied,* 459 U.S. 880 (1982); *Airco Inc. v. Simmons First National Bank,* 276 Ark. 486, 638 S.W.2d 660 (1982) ($3 million); *Hasson v. Ford Motor Company,* 32 Cal.3d 388, 185 Cal. Rptr. 654, 650 P.2d 1171 (1982) ($4 million), *cert. dismissed,* 459 U.S. 1190 (1983). Many other comparable awards, and awards in smaller amounts, have proliferated.

sums have been awarded as punitive damages in other cases against insurance companies by juries, who, left unguided, have assessed damages "in a way that can only be called freakish." *Gregg v. Georgia*, 428 U.S. 153, 206, *reh'g denied*, 429 U.S. 875 (1976).[18] The lower courts have varied unpredictably in their willingness to face the implications of such awards for fairness and due process. Although some awards have not survived judicial scrutiny,[19] many have.[20]

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[18] While perhaps some of the more exorbitant punitive damages awards have been rendered by juries in California and Arizona, *see* notes 19 and 20, *infra*, similarly outrageous awards have been handed down by Alabama juries. Two recent cases, one affirming a jury award of $1,250,000 against an insurance company on a bad faith claim, *see Nationwide Mutual Insurance Co. v. Clay*, Nos. 82-536, 82-917 (Ala. Feb. 8, 1985), and another affirming an award of $3,000,000, *see American Pioneer Life Insurance Co. v. Sandlin*, No. 82-1063 (Ala. April 12, 1985), amply demonstrate the arbitrariness of punitive damages awards in insurance litigation.

[19] *See, e.g., San Jose Production Credit Association v. Old Republic Life Insurance Co.*, 723 F.2d 700 (9th Cir. 1984) (court reversed jury award of $500,000 in punitive damages); *Egan v. Mutual of Omaha*, 24 Cal. 3d 809, 157 Cal. Rptr. 482, 598 P.2d 452 (1979), *appeal dismissed*, 445 U.S. 912 (1980) (jury award of $5 million in punitive damages against insurer for failure to conduct proper investigation of its insured's claim held to be excessive in that award was 40 times larger than the compensatory damages award and represented two and one-half months of the insurer's net income in 1973 as well as more than seven months of its income in 1974).

[20] *See, e.g., T.D.S. Inc. v. Shelby Mutual Insurance Co.*, 760 F.2d 1520 (11th Cir. 1985) (jury award of $2.1 million in punitive damages against insurer held not to be excessive); *Tibbs v. Great American Insurance Co.*, 755 F.2d 1370 (9th Cir. 1985) (court upheld award of $600,000 in punitive damages); *Dempsey v. Auto Owners Insurance Co.*, 717 F.2d 556 (11th Cir. 1983) (court held jury award of $3.1 million to be excessive and remanded with directions to require a remittitur to $1.5 million); *Frazier v. Metropolitan Life Insurance Co.* No. B004240 (Cal. App. June 10, 1984) (jury award of $8 million in punitive damages, as remitted to $2 million, overturned upon finding that claim was time-barred); *Moore v. American United Life Insurance Co.*, 150 Cal. App. 3d 610, 197 Cal. Rptr. 878 (1984) (court held $2.5 million punitive damages award not to be excessive, even though award was 83 times the amount of compensatory damages); *Sparks v. Republic National Life Insurance Co.*, 132 Ariz. 529, 647 P.2d 1127, *cert. denied*, 459 U.S. 1070 (1982) ($3 million award punitive damages for insurer's tortious termination of insurance benefits upheld); *Pistorius v. Prudential Insurance Co.*, 123 Cal. App. 3d 541, 176 Cal. Rptr. 660 (1981) (court upheld award of $1 million in

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The conduct of the insurance business suffers in particular because insurance depends heavily on the ability to make careful and exact computations of risks. Contracts of insurance are premised upon these risk calculations, and the ability of insurers to predict with relative accuracy their liabilities over a period of time is crucial to the development and maintenance of adequate reserves in any sound system of insurance.

Because the purposes and impact of punitive damages awards are plainly penal, constitutional protections akin to those accorded to criminal defendants should be afforded to defendants in punitive damages actions. A civil label should not blind this Court to their penal nature and purposes. *See, e.g., United States v. Ward,* 448 U.S. 242, *reh'g denied,* 448 U.S. 916 (1980); *Kennedy v. Mendoza-Martinez,* 372 U.S. 144 (1963). As this Court has stated:

> How simple would be the tasks of constitutional adjudication and of law generally if specific problems could be solved by inspection of the labels pasted on them! . . . Doubtless even a clear . . . classification of a statute as "non-penal" would not alter the fundamental nature of a plainly penal statute.

Trop v. Dulles, 356 U.S. 86, 94-95 (1958). Thus, although a penalty has been labeled civil, this Court has declined to view it as such where the penalty is "so punitive either in purpose or effect" as to negate such a labeling. *United States v. Ward,* 448 U.S. at 248-49.[21]

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punitive damages); *Neal v. Farmers Insurance Exchange,* 21 Cal.3d 910, 148 Cal. Rptr. 389, 582 P.2d 980 (1978) (court upheld jury award of punitive damages, as reduced to $740,000).

[21] This Court, as well as the lower courts, have been guided by the list of considerations articulated in *Mendoza-Martinez,* 372 U.S. at 168-69, in determining whether a law is penal in nature. Assessed under these factors, which are "neither exhaustive nor dispositive," *United States v. Ward,* 448 U.S. at 249, punitive damages can only be deemed penal. While punitive damages impose no "affimative disability or restraint," *Mendoza-Martinez,* 372 U.S. at 168, they typically are imposed upon a showing of "willfulness"

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Members of this Court have recognized that punitive damages are essentially penal. Indeed, this Court has stated:

> Punitive damages 'are not compensation for injury. Instead, they are private fines levied by civil juries to *punish* reprehensible conduct and to *deter* its future occurrence.'

International Brotherhood of Electrical Workers v. Foust, 442 U.S. 42, 48 (1979) (emphasis added), *quoting Gertz v. Robert Welch, Inc.,* 418 U.S. 323, 350 (1974). *See also Smith v. Wade,* 461 U.S. 30, 58 (dissenting opinion of Justice Rehnquist). Punitive damages thus further no goals of the civil law. They serve only to promote the traditional goals of punishment, namely, retribution and deterrence—goals which this Court has stated "are not legitimate nonpunitive governmental objectives." *Bell v. Wolfish,* 441 U.S. 520, 539 n. 20 (1979).

This Court in *Mendoza-Martinez* recognized that constitutional safeguards must be accorded to defendants in proceedings in which the sanction to be imposed is punishment. In striking down a statute which provided for the automatic forfeiture of citizenship as a penalty for draft evasion, the Court concluded that the statute was essentially penal, and that its application deprived the appellees of their citizenship without due process of law and without according them the rights guaranteed by the Fifth and Sixth Amendments. In so holding, the Court stated:

> What we hold is only that, in keeping with . . . cherished tradition, punishment cannot be imposed 'without due process of law.' Any lesser

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or "maliciousness", they are often assessed in amounts greater than criminal actions involving similar conduct, and no alternative purposes—other than punishment and deterrence—can rationally be assigned to them. *See* Grass, *The Penal Dimensions of Punitive Damages,* 12 Hastings Const. L. Q. 241 (1985), and Wheeler, *The Constitutional Case for Reforming Punitive Damages,* 69 Va. L. Rev. 269 (1983), for exhaustive analyses of the penal nature of punitive damages.

> holding would ignore the constitutional mandate upon which our essential liberties depend.

Mendoza-Martinez, 372 U.S. at 186.

That punitive damages actions, as they now exist, fail to comport with even the simplest notion of due process is evident from the complete lack of standards for assessing punitive damages, coupled with the unbridled discretion of judges and juries in awarding such damages. Punitive damages, in undefined and accelerating amounts, have been awarded to punish and deter conduct which ranges from "malice" to some degree of "negligence." A multitude of necessarily overlapping and somewhat redundant terms have been employed to support awards of punitive damages against a defendant whose conduct lies somewhere in between.[22] And, application of these "standards" continues to be imprecise, given the uncertainty surrounding the definitions of such terms as "malice," *see Smith v. Wade,* 461 U.S. 30, 38-41 and n.6, and given the blurred distinctions between terms like "willful," "wanton," "reckless

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[22] While awards of punitive damages have traditionally been premised upon conduct which is found to be "malicious," "willful" or "wanton", these standards, though never carefully defined, have been perceptibly lowered, permitting courts to award punitive damages against a defendant whose conduct can be characterized, at most, by some heightened degree of negligence. *See, e.g., Dempsey v. Auto Owners Insurance,* 717 F.2d 556, 561 (11th Cir. 1983) (applying Alabama's standard requiring "maliciousness, willfulness, or wanton and reckless disregard for the rights of others," court upheld punitive award as remitted to $1.5 million); *Jackson v. Johns-Manville Sales Corp.,* 727 F.2d 506, 526 (5th Cir. 1984) (applying Mississippi's requirement of a showing of "wanton, gross, or intentionally wrongful conduct," court disallowed punitive damages award); *Airco Inc. v. Simmons First National Bank,* 276 Ark. 486, 638 S.W.2d 660, 663 (1982) (defendant's reckless disregard of the consequences held to warrant $3 million punitive award); *Maxey v. Freightliner Corporation,* 450 F.Supp. 955, 963 (N.D. Tex. 1978) (punitive damages may be awarded if defendant acts "intentionally or willfully, or with a degree of 'gross negligence' which approximates a fixed purpose to bring about the injury"), *aff'd,* 623 F.2d 395 (5th Cir. 1980), *vacated and remanded upon rehearing,* 665 F.2d 1367 (5th Cir. 1982), *vacated in part and aff'd in part,* 722 F.2d 1238 (5th Cir. 1984); *Sturm, Ruger & Co. v. Day,* 594 P.2d 38, 46 (Alaska 1979), *cert. denied,* 454 U.S. 894 (1981) (even though punitive damages were warranted on the basis of

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disregard" and "conscious indifference." *See* Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 So. Cal. L. Rev. 1, 34-37 (1982).[23] Consequently, these vague and varying standards provide no real guidance to courts and juries. *Id.*[24] Moreover, the standards upon which courts rely in reviewing

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defendant's "reckless indifference to rights of others, and conscious action in deliberate disregard of them," jury award was held to be excessive); *Hansen v. Johns-Manville Products Corp.*, 734 F.2d 1036, 1043 (5th Cir. 1984), *cert. denied*, 105 S. Ct. 1749 (1985) (punitive damages awarded on the basis of Texas' "gross negligence" standard); *Campus Sweater & Sports Wear Co. v. M.B. Kahn Construction Co.*, 515 F.Supp. 64, 104 (D.S.C. 1979) (punitive damages upheld on basis of South Carolina's standard of negligence which is "so gross or reckless of consequences as to imply or assume the nature of a wantonness, willfulness or recklessness"), *aff'd without opinion*, 644 F.2d 877 (4th Cir. 1981). *See also* Meyers and Barrus, *Punitive Damages in Product Liability Cases: A Survey*, 51 Ins. Counsel J. 212 (April 1984). The Court below, in upholding the $3.5 million punitive award against Aetna, apparently deemed Aetna's conduct to be "oppressive, malicious, willful [and] fraudulent." Jurisdictional Statement, App. A at 35a.

[23] The difficulty of distinguishing between conduct which is "reckless" as opposed to merely "negligent" leads inevitably to inconsistent applications of these standards. As stated by one author:

> Unfortunately, the distinction between recklessness and negligence relates to no clear behavioral standards in the real world .... It is truly striking how we have devised a system that is not far removed from a lottery for deciding such grave matters—with the draw determined by not only the predilections of the presiding judge, but the emotions of the jury sitting in the case.

Rabin, *Dealing with Disasters: Some Thoughts on the Adequacy of the Legal System*, 30 Stan. L. Rev. 281, 297 (1978).

[24] In an opinion certifying Montana law to a Federal district court, the Supreme Court of Montana recognized this uncertainty in the area of punitive damages. *See First Bank (N.A.)—Billings. v. Transamerica Insurance Co.*, 679 P.2d. 1217 (Mont. 1984). In concluding that insurance coverage of punitive damages does not violate Montana's public policy, the court noted that "juries and judges typically award punitives for a broad range of conduct not often described as willful or wanton, but as merely reckless or unjustifiable." *Id.* at 1222. Refusing to preclude such insurance coverage in light of the uncertainty in the area of punitive damages, the court further stated that "fact-finders ... wrestle with concepts like recklessness and reasonableness,

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jury awards of punitive damages are equally imprecise, requiring judges to inquire generally whether an award reflects the passions or prejudices of the jury.[25]

Similarly vague are the standards used for determining the amount of punitive damages to be assessed against a defendant. This amount is generally left to the sole discretion of the jury, guided only by certain ill-defined factors relating to the nature of the defendant's misdeed and including the wealth of the defendant, thus emphasizing the punitive nature of the award. The lack of standards, and, indeed, of rationality, for assessing punitive damages has prompted members of this Court to comment on the arbitrary and prejudicial nature of punitive damages awards. As Justice Powell stated in *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1973):

> In most jurisdictions jury discretion over the amounts [of punitive damages] awarded is limited only by the gentle rule that they not be excessive. Consequently, juries assess punitive damages in wholly unpredictable amounts bearing no necessary relation to the actual harm caused.

See also International Brotherhood of Electrical Workers v. Foust, 442 U.S. 42, 50-51 (1979); *Smith v. Wade*, 461 U.S. 30,

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such that defendants may not know that their conduct constituted presumed malice until after trial, and that a defendant in one case may never know the sting of punitive damages while another defendant in a similar case may be faced with financing a sizeable award." *Id.* Recognizing, as the Montana Supreme Court did, the randomness of punitive damages awards, the Montana legislature passed legislation, effective April 16, 1985, limiting the applicability of punitive damages. The statute requires, *inter alia*, that the elements of a claim for punitive damages be proven by clear and convincing evidence, and places limits on the amounts in which punitive damages can be awarded. *See* Mont. Code Ann. § 27-1-221 (1983), as amended by House Bill 363.

[25] The potential for arbitrariness is inevitably increased when articulable standards are not applied to judicial action. *See* pp. 3-5, *supra*. Resort to *ad hoc* decisions regarding judicial ethics is an inappropriate, and ineffective, method of protecting constitutional rights. Only the application and enforcement by judicial tribunals of sound constitutional standards, establishing predicate conduct and adequate procedures and governing the proportionality of awards, can adequately ensure that these rights are not abrogated.

56-65, 92-94 (dissenting opinions of Justices Rehnquist and O'Connor).[26]

Despite the complete lack of standards for assessing punitive damages, no unique procedures have been developed to protect a defendant in a punitive damages action from the risk that such damages will be improperly awarded, based upon the whim or caprice of a judge or jury. Further, the absence of procedures satisfying even the most fundamental concepts of due process results in arbitrary and erroneous deprivations of property, and in the stigma which necessarily attaches to a defendant whose conduct is characterized as "fraudulent," "malicious" or "wanton". Due process cannot be satisfied in a punitive damages action without detailed and carefully tailored procedural safeguards, such as an elevated standard of proof, limitations on the amounts of punitive damages, and bifurcation of punitive damages trials.

The constitutional infirmities which inhere in punitive damages actions should no longer be ignored. If not eliminated entirely from the field of insurance—an area where they do not belong—punitive damages should be limited, and defendants should, at a minimum, be accorded the constitutional protections guaranteed to other defendants who are subject to punishment by juries and courts. The ultimate responsibility rests with this Court to guard against stealthy encroachments upon constitutional rights by practices which spring from unjustified deviations in the law. No better example of a stealthy encroachment—and one which should be halted by this Court—exists than punitive damages.

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[26] As Justice Rehnquist stated in *Smith v. Wade* (461 U.S. at 87-88):

> It is anomalous, and counter to deep-rooted legal principles and common-sense notions, to punish persons who meant no harm, and to award a windfall, in the form of punitive damages to someone who already has been fully compensated. These peculiarities ought to be carefully limited—not expanded to every case where a jury may think a defendant was too careless, particularly where a vaguely defined, elastic standard like "reckless indifference" gives free reign to the biases and prejudices of juries. In short, there are persuasive reasons not to create a new punitive damages remedy unless it is clear that Congress so intended.

B. The Decision Below Imposes an Excessive Fine in Violation of the Eighth Amendment

Whereas due process provides safeguards against procedures which result in arbitrary awards and standardless verdicts, the Eighth Amendment provides an added protection against arbitrariness and excessiveness in punishment. Focusing upon the result itself, the Eighth Amendment ensures that punishment will not be meted out arbitrarily, or in excessive amounts wholly disproportionate to the offense. Even assuming that the procedures employed in assessing and upholding punitive damages awards comport with due process—which they do not—the decision below cannot survive scrutiny under the Eighth Amendment.

The Eighth Amendment's ban against excessive punishments and requirement of proportionality derive from English law. By the thirteenth century, discretionary amercements, often excessive and oppressive, had become prevalent in England—so prevalent that three chapters of the Magna Carta were devoted to their control.[27] Indeed, Chapter 20 of the Magna Carta, setting forth the rule against excessiveness in punishment, provided:

> A free man shall not be amerced for a trivial offence, except in accordance with the degree of the offence, and for a serious offence he shall be amerced according to its gravity, saving his livelihood; and a merchant likewise, saving his merchandise; in the same way a villein shall be amerced saving his wainage; if they fall into our mercy. And none of the aforesaid

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[27] *See* Granucci, "*Nor Cruel and Unusual Punishment Inflicted*": *The Original Meaning*, 57 Cal. L.R. 839, 845 (1969). The amercement was the equivalent of the modern fine. Amercements, given their discretionary character, permitted the circumstances of each case to be considered, and the fine fixed accordingly, but invited the opportunity for arbitrariness and excessiveness. *Id.*

> amercements shall be imposed except by the testimony of reputable men of the neighborhood.

J. Holt, *Magna Carta* 323 (1965).[28]

The principle that amercements could not be excessive was reiterated in the English Bill of Rights of 1689, which, in language borrowed by the framers, strove to curb selective and arbitrary application of harsh penalties by incorporating "the longstanding principle of English law that the punishment . . . should not be . . . greatly disproportionate to the offense charged." R. Perry, *Sources of Our Liberties* 236 (1959). Evidencing the intent of the English Bill of Rights to preclude disproportionate and excessive fines, the House of Lords, "barely three months after the Bill of Rights was adopted . . . declared that a 'fine of thirty thousand pounds, imposed by the court of King's Bench upon the earl of Devon was excessive and exorbitant, against magna charta, the common right of the subject, and the law of the land." *Solem v. Helm,* 463 U.S. 277, 285 (1983), *quoting Earl of Devon's Case,* 11 State Tr. 133, 136 (1689).

The concept of proportionality which was firmly embedded in English law by 1689 was transplanted to American soil, and ultimately incorporated into the Bill of Rights as the Eighth Amendment. *See Solem v. Helm,* 463 U.S. at 285-86. This "constitutional principle of proportionality," *id.* at 286, was recognized by this Court as early as 1910. In *Weems v. United States,* 217 U.S. 349, 367 (1910), the Court held that the Eighth Amendment precluded the punishment of 15 years of imprisonment plus hard labor in chains for the crime of falsifying a public document, noting "that it is a precept of justice that punishment for crime should be graduated and proportioned to the offense." On repeated occasions since *Weems,* the Court has resorted to the constitutional principle of

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[28] Maitland said of this chapter that "very likely there was no clause in the Magna Carta more grateful to the mass of the people." F. Maitland, Pleas of the Crown for the County of Gloucester xxxiv (1884), *cited in* Granucci, *supra,* at 845.

proportionality to conclude that certain punishments are, or are not, excessive.[29] Most recently, this Court in *Solem* revisited the concept of proportionality in punishments, holding that the Eighth Amendment prohibits a life sentence, without possibility of parole, for the commission of a seventh nonviolent felony.[30]

Although this Court has had little occasion to address the Excessive Fines Clause of the Eighth Amendment, the cases decided under the Cruel and Unusual Punishments Clause provide a useful framework for assessing the validity of punitive damages under the Eighth Amendment—an issue of first impression in this Court. In light of the common origin of the clauses of the Eighth Amendment, the concept of proportionality should be equally applicable to all of the clauses of the Amendment. Indeed, as this Court has stated:

> We have recognized that the Eighth Amendment imposes 'parallel limitations' on bail, fines, and other punishments, *Ingraham v. Wright, supra,* at 664, and the text is explicit that bail and fines may not be excessive. It would be anomalous indeed if the lesser punishment of a fine and the greater punishment of death were both subject to proportionality analysis, but the intermediate punishment of imprisonment

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[29] *See Coker v. Georgia,* 433 U.S. 584 (1977) (death sentence held to be grossly disproportionate and excessive for the crime of rape); *Trop v. Dulles,* 356 U.S. 92 (1958) (expatriation for wartime desertion violated the Eighth Amendment); *Enmund v. Florida,* 458 U.S. 782 (1982) (death penalty for felony murder held to be excessive under the circumstances); *Gregg v. Georgia,* 428 U.S. 153 (1976) (death penalty for murder upheld).

[30] In so holding, the Court weighed the gravity of the offense and the harshness of the penalty, and looked to the sentences imposed for similar conduct in the same and other jurisdictions, stating that "[i]f more serious crimes are subject to the same penalty, or to less serious penalties, that is some indication that the punishment at issue may be excessive." *Id.* at 291. Applying the considerations enunciated in *Solem,* a punitive award, 2,100 times the amount of actual damages, is obviously excessive and grossly disproportionate to the offense of bad faith failure to pay an insurance claim. Moreover, consideration of the fines allowed for violation of the Alabama Insurance Code, which proscribes a general practice of refusing to pay or settle claims, removes all doubt that the award here was excessive. Section 27-1-12 of the Alabama Code provides that a *willful* violation of the statute is punishable, at most, by a $1,000 fine. *See* Ala. Code § 27-1-12 (1975).

> were not. There is also no historical support for such an exception.

Solem v. Helm, 463 U.S. at 289.

The governing principle of proportionality as a protection against arbitrariness and excessiveness in punishment compels reversal of the award of $3.5 million against Aetna for the "offense" of paying only a portion, rather than the whole, of a $3,000 insurance claim. The award of $3.5 million in punitive damages against Aetna was rendered in a proceeding which failed to comport with due process, and which permitted the jury to award punitive damages in an amount which was arbitrary and wholly disproportionate to the offense charged.[31] The complete absence of standards for assessing punitive damages (an infirmity which would not survive in other criminal contexts) has led inevitably to a proliferation of similar punitive awards—a result which the Eighth Amendment proscribes.

Despite the magnitude of the punitive damages award assessed against Aetna, the court below concluded that "the verdict is [not] so excessive as to warrant a finding that it was based upon bias, passion, prejudice or some other improper motive." Jurisdictional Statement, App. A at 35a. To call the verdict below anything but excessive, however, rejects the concept of proportionality, and gives open-ended indulgence to the sort of judge or jury passion that inflates such awards. By upholding an award of $3.5 million in punitive damages—a punishment that is over 2,100 times the amount of actual

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[31] Significantly, this Court, reviewing the role of the jury in meting out criminal sentences, has emphasized the importance of providing proper guidance to juries to protect against arbitrary and discriminatory sentences. *See Gregg v. Georgia*, 428 U.S. at 189 ("discretion must be suitably directed and limited so as to minimize the risk of wholly arbitrary and capricious action"). Although guidance has traditionally been provided to juries assessing punishment in criminal contexts, no similar guidance—or, at least, no useful guidance—has been rendered by courts to juries vested with the power to assess punitive damages.

damages allegedly suffered—the court below has sanctioned a scheme of punishment which bears no rational relation to the offense charged.[32] Such punishment should not be upheld under the plain words and purposes of the Eighth Amendment.

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[32] This Court has held a fine of $3.5 million to be excessive. In *United States v. United Mine Workers*, 330 U.S. 258, 304-05 (1947), this Court concluded that an unconditional fine of $3.5 million against a union for criminal contempt was excessive, in light of the character of the defendant's conduct, the effectiveness of the sanction, the financial resources of the defendant and the burden imposed upon the defendant. The Court reduced the fine to $700,000, with an additional fine of $2,800,000 payable if the defendant persisted with its noncompliance with a restraining order.

CONCLUSION

For the reasons set forth above and for the additional reasons advanced in the Brief for the Appellant, the decision below should be reversed.

Respectfully submitted,

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